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C O N F I D E N T I A L SECTION 01 OF 03 TEL AVIV 002940

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SUBJECT: FINANCE MINISTRY DIRECTOR GENERAL TELLS AMBASSADOR

GOI ASSISTANCE REQUEST STILL AT PLANNING STAGE

Classified By: Ambassador Daniel C. Kurtzer for Reasons 1.4 (b,d)

1. (C) Summary. The Ambassador met May 9 with Finance Ministry DG Yossi Bachar to discuss a full range of bilateral economic issues, including Israel's request for U.S. assistance to promote Negev/Galilee development, an overview of the recently-concluded Joint Economic Development Group (JEDG) meeting, IPR and other issues. During the meeting, Bachar:

-- Noted the GOI has not yet fleshed out its plans for the Negev/Galilee regions and the issue was not likely to be raised formally by the GOI in the upcoming visit of PM Sharon to the U.S.;

-- Said he would be chairing a meeting May 24 with all involved ministries to consider next steps on the issue and that he might travel to the U.S. for further discussions on the issue;

-- Said the GOI did not yet have an exact accounting of its disengagement expenses to provide to the USG, in part because the possibility existed that the GOI would pay more for compensation if it would help secure a successful, peaceful disengagement;

-- Noted the April JEDG meeting had gone "smoothly" and MoF and Embassy staffs were working on closing out remaining 2005 terms sheet issues;

-- Explained that he had possibly misspoken at the JEDG when he claimed GOI legislation includes a 3.4% budget deficit target, including disengagement, for 2006 as well as for

2005. Bachar promised to provide clarification soon;

-- Admitted he felt the GOI could have done more on IPR and promised to look into ways to deal with the issue;

-- Promised to help resolve a major tax issue involving the American International School; and

-- Said he would look into the GOI's purchase of a non-U.S. scanner for the Haifa port utilizing US FMF funding.

End Summary

Israeli Negev/Galilee
Assistance Request "Not Ready"

2. (C) Bachar briefed the Ambassador on Israel's request for U.S. assistance for Negev and Galilee development. He said he had participated in a useful meeting with Deputy National Security Advisor for Economic Affairs Shirzad, in which Bachar had outlined some of the GOI's thinking on the issue. Bachar termed the meeting a "kickoff" in which the "rules of the game" had been discussed. Bachar said the GOI was thinking along the lines of a long-term development plan augmented by U.S. assistance, and not in terms of U.S. assistance somehow related to an undefined plan. Bachar said the meeting did not focus on potential U.S. assistance for Israeli disengagement. Furthermore, it had generated no follow-up taskings. Bachar seriously doubted whether the GOI would be in a position to raise assistance for either Negev/Galilee or for disengagement during the PM's scheduled May 24-25 visit to Washington, although he noted he might travel to Washington for further discussions.

3. (C) Bachar said the idea for resuscitating GOI plans for the Negev and Galilee had originated with the PM's Director General Ilan Cohen. Since then, Shimon Peres had taken the lead on the civilian aspects of the development plan. Bachar said the concept of such development was not new, but noted that the GOI had decided to give them a newly energized push. Bachar expected to chair a meeting of all involved ministries on May 24 to consider next steps on the project.

4. (C) The Ambassador reminded Bachar that the USG was waiting for an estimate of disengagement costs, which would fulfill a request made by U/S Larson late in 2004. Bachar noted that the GOI did not yet have "precise" numbers for disengagement, noting that the main area of uncertainty remained in the civilian sphere. The GOI, Bachar stressed, would do almost whatever it took in order to make certain disengagement went smoothly. If this took further expenditures to keep the settlers quiet, so be it. Although it was possible such expenditures could result in a higher 2006 deficit than currently estimated, Bachar said he was committed to preventing such an outcome. Bachar hinted that one reason the GOI did not want to provide an exact estimate of disengagement expenses was that such an estimate would

provide settlers a stronger position from which to bargain for higher compensation levels.

JEDG: A Good Meeting

15. (C) Bachar summed up the recently-concluded Joint Economic Development Group (JEDG) meeting by noting that it had "gone smoothly." MoF staff, he noted, were now working with the Embassy to help iron out the details of the 2005 terms sheet.

(Note: The terms sheet outlines the specific economic terms Israel must meet to receive future tranches of loan guarantees. End Note) On a related note, Bachar said that he believed he had erred when he informed A/S Wayne during the JEDG that GOI legislation had institutionalized a deficit level of 3.4 percent, with disengagement, for both 2005 and 2006, "I believe the legislation includes a specific level for 2005 only." Bachar promised to supply the Embassy with more specific information soon. The Ambassador noted that, in relation to the Loan Guarantee Agreement, the U.S. had not taken any settlement deductions since 2003. As a result, and in view of Israel's continued funding of settlements, the GOI had run up a potentially significant amount of future deductions. Bachar said he recognized this fact. Econ Deputy raised FinMin Netanyahu's reported intention to issue a new, ambitious program of tax reductions this year, and asked how Bachar saw that relating to the LGA language urging the GOI to give due consideration to the reduction of Israeli debt/GDP levels. Bachar responded that, although the GOI was also concerned about overall debt levels, states with high tax rates were at an economic disadvantage internationally.

IPR

16. (C) The Ambassador noted that, in the 2004 terms sheet, the GOI had agreed to try to work out differences with the U.S. on IPR. This had not yet happened, and Israel had now been placed on the Priority Watch List. Although it was unlikely Israel would be moved even higher on the list and thus be subject to possible sanctions, the Ambassador noted PWL was not a good place to be and urged Bachar to help out. While noting that the MoF did not have primary action on the issue, Bachar noted that "frankly, I think we could have done better on this issue" and promised to see if he could help in some way. The Ambassador also noted negative developments on the patent term extension and promised to provide Bachar more specific information on the issue.

American School Tax Issue

17. (C) The Economic Counselor outlined a disagreement between the American International School and the GOI tax authorities relating to whether the school would have to pay VAT tax on property it had purchased for its new campus. According to an agreement reached in the 1960s between then Ambassador Barbour and then PM Golda Meir, the GOI agreed to consider the school legally the same as the Embassy for tax purposes. Unfortunately, it appeared the GOI was taking advantage of the school's expansion to reevaluate this agreement, a move that was in neither country's interest. The Ambassador noted imposing a new tax on such a major purchase could unnecessarily put the school's future into question. Bachar appeared genuinely concerned over the disagreement and promised to speak to the tax authorities to reach a resolution.

Haifa Port Scanner

18. (C) The Ambassador closed out the meeting by noting the GOI had decided to utilize USG FMF funding to purchase a non-U.S. origin scanner at Haifa port. This was against both the spirit and the letter of FMF and was unacceptable. Bachar asked for more information on the issue and promised to do what he could to correct the problem.

Bachar Committee
Recommendations to Knesset

19. (C) Bachar noted that, in spite of all the work the ministry was doing to make certain disengagement proceeded successfully, it had not dropped economic reform. In just one example, he said that his own recommendations for financial market reform would be submitted to the Knesset the week of May 20.

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KURTZER